



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

file

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date:

JUN 13 2002



Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

According to your Form 1023 Application, you were organized on [REDACTED] as a [REDACTED]. Your articles of organization state a purpose to conduct any lawful activity. You have no operating agreement. Your sole member, director, and officer was [REDACTED] and now is [REDACTED].

You solicit donations of clothing and other household items, through outdoor collection bins and truck pick-ups. You sell the contributed property at a thrift store and warehouse and contribute net proceeds to breast cancer charities, churches, programs to help the poor, elderly, and handicapped, and directly to needy people referred by local charitable or governmental organizations. You also give clothing to needy people who receive vouchers from other charities, and to people attending regular give-away events.

Your financial statements indicate profits from operations of [REDACTED]% of revenues (\$[REDACTED]/\$[REDACTED]) and [REDACTED]% (\$[REDACTED]/\$[REDACTED]) in years [REDACTED] and [REDACTED]. Cash contributions paid out during these periods were \$[REDACTED] and \$[REDACTED] ([REDACTED]% and [REDACTED]% of revenues). The audited financial statement also lists distributions of collected clothing and services to the poor (by your employees) valued at \$[REDACTED] and \$[REDACTED] ([REDACTED]% and [REDACTED]% of revenues). Your payroll expenses were \$[REDACTED] (\$[REDACTED] administrative) in [REDACTED] and \$[REDACTED] (\$[REDACTED] administrative) in [REDACTED]. You have failed to furnish industry averages and information upon our request, claiming none is available.

Originally, your sole member/director/officer, [REDACTED], received \$[REDACTED] compensation. He also received some \$[REDACTED] for child care; an audit revealed that the



payments were improper, and [REDACTED] repaid the amounts in a subsequent year. You state that you have adopted a policy prohibiting such transactions. [REDACTED] wife, [REDACTED], served as part-time bookkeeper and outside marketing representative, and was listed as VP Operations on Form 990, receiving \$[REDACTED] per year, along with [REDACTED] (VP Marketing, \$[REDACTED]).

[REDACTED] resigned [REDACTED]. Now, your sole member, director, and officer is [REDACTED], who receives \$[REDACTED] per year plus fringe benefits that you describe as "customary," without elaboration. You also have a staff of employees.

Under [REDACTED] law, a member is entitled to receive distributions from an LLC to the extent and at the times or upon the happening of events specified in the operating agreement or at the times determined by the members or managers. [REDACTED] Gen. Stat. § [REDACTED]. An LLC generally is dissolved and its affairs shall be wound up upon the consent of a majority in interest of the members. § [REDACTED]. Upon winding up, assets are distributable to creditors and members. § [REDACTED]. At the time a member becomes entitled to receive a distribution, the member has the status of a creditor. § [REDACTED].

Section 501(c)(3) of the Internal Revenue Code exempts from federal income tax organizations organized and operated exclusively for charitable or other exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations defines a "private shareholder or individual" as a person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is "organized" exclusively for one or more exempt purposes only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal Government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders.



Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization "operates exclusively" for 501(c)(3) purposes only if it engages primarily in activities that accomplish such purposes. It does not operate exclusively for 501(c)(3) purposes if more than an insubstantial part of its activities does not further such purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes under section 501(c)(3) of the Code unless it serves a public rather than a private interest. Thus, an organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled by such private interests.

Rev. Rul. 80-106, 1980-1 C.B. 113, held exempt under section 501(c)(3) of the Code an organization that operated a thrift shop that sold used clothing and household furnishings to the general public. All of the organization's profits were required by its governing documents to be distributed to specified organizations described in section 501(c)(3). Substantially all of the work in operating the thrift shop was performed by volunteers without compensation. The items sold by the organization were collected from the general public, most on consignment and some by donation. The Service reasoned that the organization's sales were excepted from unrelated business, and therefore sections 502 of the Code and 1.501(c)(3)-1(e)(1) of the regulations did not disqualify the organization from exemption. Also, the consignment transactions were reasonable and did not result in inurement or private benefit.

In Better Business Bureau v. United States, 316 U.S. 279 (1945), the Supreme Court held that an organization was not organized and operated exclusively for charitable purposes. The court stated that the presence of a single non-exempt purpose, if substantial in nature, will destroy exemption regardless of the number or importance of truly exempt purposes.

In Senior Citizens Stores, Inc. v. United States, 602 F.2d 711 (5th Cir. 1979), the court upheld the Commissioner's determination that the organization's retail sales operation was an end in itself rather than merely a means of accomplishing a charitable goal, and therefore the organization was not devoted exclusively to charitable purposes. The organization's stated purpose was to provide training, jobs, places of recreation, and living accommodations, and to improve the physical and mental conditions of aged or senior citizens. The organization engaged in the business of selling used clothing, furniture, and household appliances which were donated to the organization by the general public. Its affairs were run by a board of three directors, two of whom were father and son. The organization reported net income. Although half of the organization's 13 employees were over 55, their training was restricted to the needs of plaintiff's business, and the organization conducted no training program beyond the training of employees for its own shops. The organization did not provide any housing facilities or health care. 10% or less of the donated items were distributed directly to needy senior citizens, although no complete records were kept of such distributions and the organization apparently conducted no advertising to let senior citizens know of the availability of such items. There was no evidence that senior citizens received a discount on purchases from the stores. The organization maintained a recreation hall above one of its three stores. The only evidence of



business proceeds devoted to the recreation hall was a \$160 monthly salary paid to its part-time director. The court concluded that the business was not distinguishable from that of many typical family-operated businesses in which the excess of income over expenses is paid to various family members as rents or salaries.

University of Maryland Physicians, P.A. v. Commissioner, T.C.M. 1981-23, held exempt under section 501(c)(3) of the Code a professional service corporation established by clinical departments of a teaching hospital for administrative efficiencies in collecting professional fees. Each shareholder was a hospital staff physician and faculty member of the affiliated school. The court accepted the corporation's for-profit status because that was the only kind of corporation permitted to practice medicine in the State.

We find that you are not "organized" exclusively for exempt purposes. Your articles of incorporation fail to meet the 501(c)(3) organizational test, for several reasons. The articles do not limit your purposes to charitable purposes. They expressly empower you to engage in non-exempt activities. Also, as discussed below, your assets are not dedicated to an exempt purpose but, by law, are distributable to your member upon dissolution (if not earlier).

You are organized as an LLC. Organizations described in section 501(c)(3) of the Code, whether corporations, associations, or trusts, generally are organized as nonprofit or charitable organizations. In the University of Maryland case, the court recognized exemption of the entity, organized under for-profit laws, under the compelling circumstance that the organization could not otherwise practice medicine, a recognized charitable activity. LLCs are comparable to for-profit corporations in that the member-owners control the organization and have the potential right to receive distributions of the LLC's earnings and other assets, upon dissolution if not earlier. You have one member, an individual. A distribution in whole or part of your assets to him would constitute inurement of your net earnings to private shareholders or individuals. Because of the lack of legal authority in [REDACTED] and elsewhere recognizing and enforcing not-for-profit LLCs, the Service is unwilling to recognize the 501(c)(3) exemption of LLCs unless all of its members are 501(c)(3) organizations or governmental units or instrumentalities. Therefore, you are not organized exclusively for charitable purposes.

For the same reason, we cannot determine that your net earnings will not inure to the benefit of your sole member. Moreover, your payment of [REDACTED] child care expenses was another form of inurement. Although you characterize the payments to your sole member/director/officer as an aberration, you have no one exercising any oversight of your sole member/director/officer, and we have no assurance (other than a bare representation from you) that this kind of improper payment of personal expenses, whether in the form of child care expenses, automobile for personal travel, and the like, will not happen again.

We also find that you are not operated exclusively for exempt purposes for other reasons. Your operations strike us as similar to those described in Senior Citizens Stores. As in that case, you operate a thrift shop, engaged in the business of selling used clothing and other items donated by the public. Your sole member controls your affairs. You report net income, but your distributions are well below your net income levels. Your executive compensation actually exceeds your charitable distributions for years for which information was



[REDACTED]

provided. We asked you for industry data to determine whether your levels of giving are reasonable in the industry, but you did not provide any. You have operated for years without filing tax returns of any kind. Under the circumstances, your business is difficult to distinguish from that of many typical family-operated businesses in which the profits are paid over to family members or other officers as salaries. Thus we find that you have a substantial non-exempt purpose to conduct business for its own sake.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service

[REDACTED]  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224



[REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

  
[REDACTED]  
Acting Manager  
Exempt Organizations  
Technical Group 2

Instructor

[REDACTED]

6/10/02

Reviewer

[REDACTED]

6/10/02